

Conflicts of Interest

Under the Political Reform Act
of 1974

(These slides were presented at a
one-day seminar in Rhonert Park
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History of the Political Reform Act of 1974

- Prior to passage of the PRA, state laws governing the conduct of public officials and campaign committees were weak and largely ignored.
- It began as a ballot measure, proposition 9, which was introduced by a coalition of reformers.
- The measure was the most detailed disclosure law in the country, and it included new requirements for reporting campaign and lobbying activities.
- Passed in 1974 by nearly 70 percent of voters.

Purposes

The PRA seeks to bring a degree of credibility to government by providing that those who hold a public trust must act, and appear to act, ethically. Erosion of confidence in public officials is detrimental to democracy.... To maintain confidence and to avoid public skepticism, conflicts of interest must be shunned."

*Consumers Union of U.S., Inc. v.
California Milk Producers Advisory
Bd. (1978) 82 Cal.App.3d 433.*

The PRA:

- Created a new independent state agency – The Fair Political Practices Commission.
- The FPPC administers, interprets and enforces the provisions of the PRA.
- The Act also governs disclosure of political campaign contributions and spending by candidates and ballot measure committees, as well as regulates lobbying practices and disclosure. It also sets ethics rules for state and local government officials.

The Political Reform Act of 1974

Can only be amended by:

- Another initiative measure, or
- A 2/3rd vote of the legislature so long as the change furthers the purposes of the Act.

Conflicts of Interests under the Political Reform Act:

The Basic Rule

No public official at any level of state or local government shall make, participate in making or in any way attempt to use his or her official position to influence a governmental decision in which he or she knows or has reason to know that he or she has a financial interest.
(G.C. 87100)

When Does a Public Official Have a Conflict?

A public official has a financial interest in a decision within the meaning of Section 87100 if it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official, a member of his or her immediate family, or on any “economic interest.” (G.C. 87103)

The 8 Steps (Steps 1-6: Conflict of Interest.)

- Step 1:** Is the individual a *public official*?
- Step 2:** Is the official *making, participating in or influencing* a governmental decision?
- Step 3:** What are the official's *economic interests*?
- Step 4:** Is the economic interest *directly or indirectly* affected by the decision?
- Step 5:** How will the economic interest be affected? (*material financial effect*)
- Step 6:** Is it *reasonably foreseeable* that the economic interest will be materially affected?

The 8 Steps, cont. (Steps 7 and 8: Exceptions.)

Step 7: If the economic interest will be materially affected, will the decision affect the official's economic interest in substantially the same manner as it will affect a significant segment of the *public generally*?

Step 8: If not, are other officials also disqualified so that the "*legally required participation*" rule applies?

Step 1: Is the Individual a “Public Official”?

The term “public official” includes **every** member, officer, employee or consultant of a state or local agency. “Member” means members of boards, commissions or committees that possess decision-making authority. (Reg. 18701(a)(1).)

Exception: Unsalaries membership on a solely advisory board/commission.

More Difficult Determinations:

In limited circumstances, the members of a nonprofit organization may be "public officials." (*In re Siegel* (1977) 3 FPPC Ops. 62.)

“Consultant”

A “consultant” under contract to an agency is a public official when that person:

- (a) Makes specific governmental decisions, or
- (b) Serves in a staff capacity and in that capacity participates in making governmental decisions; or performs the same/substantially the same functions as a position specified in the agency’s conflict of interest code. (Reg. 18701(a)(2)(B).)

Step 2: Is the Official Making, Participating In Or Using His/Her Position To Influence A Governmental Decision?

An official “makes” a decision when he/she:

- (a) **Votes** on a matter;
- (b) **Appoints** a person to a board or commission;
- (c) **Obligates/commits** the agency to a course of action;
- (d) **Enters into contractual agreements;** or
- (e) **Determines not to act** because of a conflict.

An Official “Participates” in a Decision When He/She:

Negotiates, without significant substantive review; or advises or makes recommendations to the decision-maker without significant intervening substantive review by:

- (a) Conducting research/making an investigation which requires the exercise of judgment and the purpose of which is to influence a decision; or
- (b) Preparing/presenting any report, analysis, or opinion which requires the exercise of judgment and the purpose of which is to influence the decision.

An Official “Influences” a Decision When the Official:

(a) Contacts, appears before, or otherwise attempts to influence any member, officer, employee or consultant of his/her agency regarding a decision before his/her agency or an agency appointed by/subject to the budgetary control of his/her agency.

(b) For all other decisions, the official “influences” if the official acts or purports to act on behalf of, or as the representative of, his/her agency for the purpose of influencing the decision.

Step 2: Making, Participating in or Influencing (cont.)

Exceptions -- There are a variety of exceptions to these definitions, including:

- Actions of public officials which are solely ministerial, secretarial, manual, or clerical;
- Appearances by a public official as a member of the general public before an agency in the course of its prescribed governmental function to represent himself or herself on matters related *solely* to the official's **personal interests**.

Step 2: Making, Participating in or Influencing (cont.)

NEW RULE (§ 87200 filers): Leave the Room Requirement

- If you are disqualified you must comply with new rules which require you to announce your conflict of interest and leave the room when the decision is presented.
- In limited circumstances, however, you may speak as a member of the public.
- § 87200 filers include “other public officials who manage public investments.”

Step 3: What Are the Official's Economic Interests? (Six types)

1. **Personal finances** of public official or of his/her immediate family. "Immediate family" means the spouse and dependent children. (§ 82029.)

2. **Business Investment** in which the official or a member of his/her immediate family has an investment of \$2,000 or more

Step 3: Economic Interests (cont.)

3. Business Employment or Management in which the official is a director, officer, partner, trustee, employee, or holds any position of management

4. Real property in which the official or a member of his or her immediate family has an interest worth \$2,000 or more.

Step 3: Economic Interests (cont.)

5. Sources of income (other than loans by a commercial lending institution) aggregating \$500 or more, received or promised to the official within 12 months prior to the time the decision is made.

6. Sources of a gift or gifts valued at \$360 or more received by, or promised to the official, within 12 months prior to the time the decision is made. This threshold is tied to the gift limit threshold and adjusted every two years.

New Rule Domestic Partners

- A public official's "immediate family" includes the official's spouse and dependent children.
(§ 82029.)
- For purposes of this title and implementing regulations, the term "spouse" shall include *registered* domestic partners recognized by state law.
(§ 18229.)

Step 4: Is the Economic Interest “Directly” or “Indirectly” Affected by the Decision?

“Directly Involved”

Business Entities, Sources of Income, & Sources of Gifts: The source or entity **initiates the proceeding** by filing an application, claim, appeal, or similar request, or is a **named party in a proceeding**. A person is a subject of a proceeding if a decision involves the issuance, renewal, approval, denial or revocation of any license, permit, or other entitlement to, or contract with, the subject person.

Step 4: Is the Economic Interest “Directly” or “Indirectly” Involved in the Decision? (cont.)

“Directly” Involved Personal Financial Effect

- If there is any financial effect on the personal finances of a public official or his or her immediate family they are deemed to be directly involved in a decision. (Regulation 18704.5)

Step 4: “Direct” or “Indirect,” (cont.)

Real Property is “directly” involved in a decision if:

(1) The official’s property is within 500 feet of the boundaries (or proposed boundaries) of the property which is the subject of the decision;

(2) The decision involves the zoning, rezoning, annexation, deannexation, sale, purchase, lease, or inclusion in or exclusion from any governmental subdivision of the property;

(3) The decision involves the issuance, denial or revocation of a license, permit or other land use entitlement;

Step 4: “Direct” or “Indirect,” (cont.)

Real Property Directly involved in a decision if:

(4) The decision involves the imposition, repeal or modification of any taxes or fees assessed or imposed on the property;

(5) The decision involves the designation of the survey area, selection of the project area, adoption of the preliminary plan, formation of a project area committee or adoption of a redevelopment plan; or

(6) The decision involves the construction of, or improvements to, streets, water, sewer, storm drainage or similar facilities and the real property will receive new or improved services.

Step 4: “Direct” or “Indirect,” (cont.)

“Real Property” in which a public official has an economic interest is indirectly involved if the decision:

(1) Solely concerns amendment of an existing zoning ordinance or other land use regulation that is applicable to *all* other properties designated *in that category*, or

(2) Solely concerns repair, replacement or maintenance of existing streets, water, sewer or similar facilities.

Final Note, Step 4:

If a public official's economic interests are not "directly" involved in a decision, the interest *is* "indirectly" involved.



Step 5

How Will the Official's Economic Interests be Affected by the Decision? (Materiality)

Step 5 Materiality Standards: 18705.2

Real Property Interests (excluding leaseholds)

Direct: Deemed material unless the public official can prove that the decision will have *no* effect on the value of real property

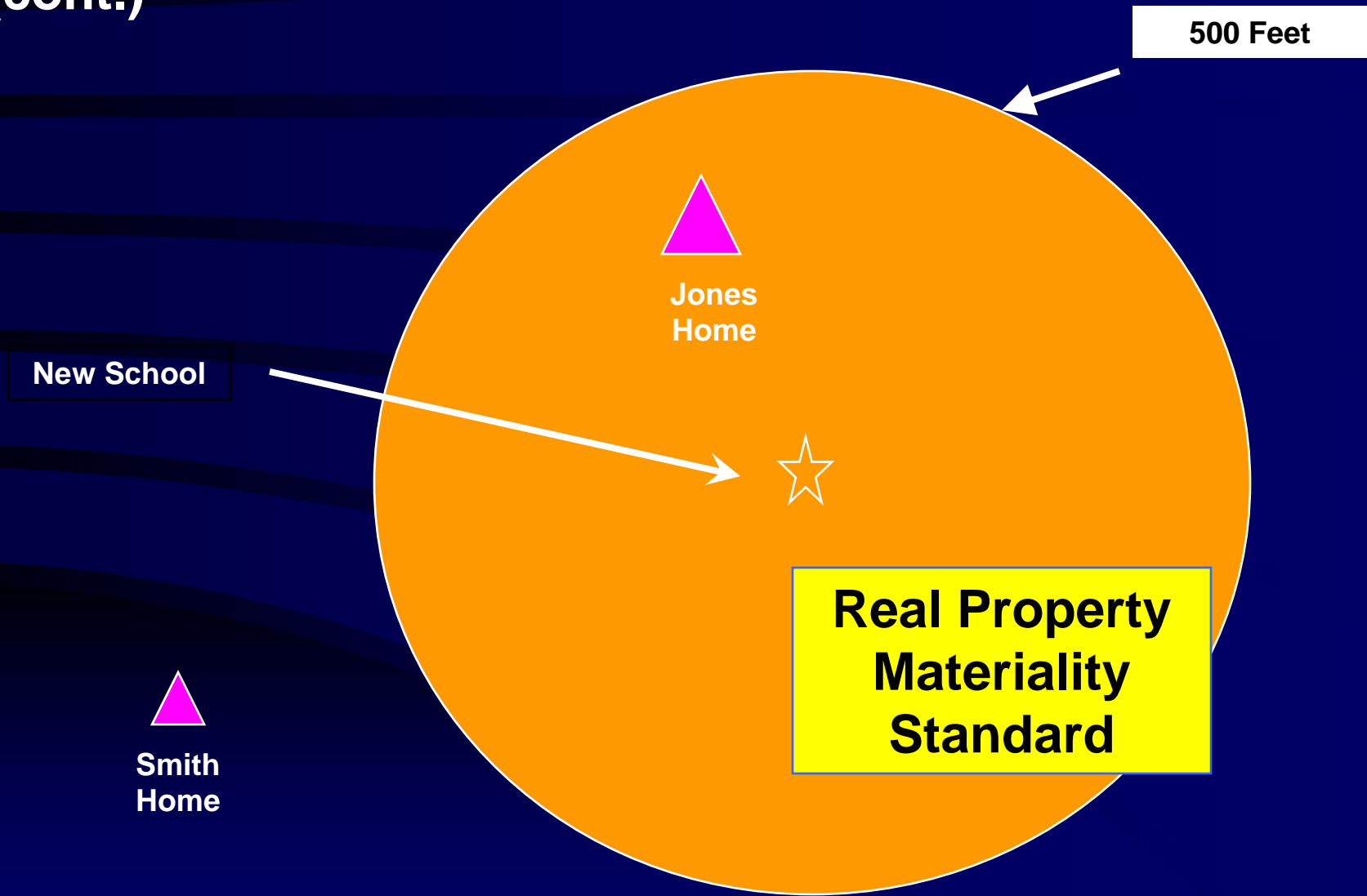
Indirect: Presumed not to be material unless special circumstances regarding the decision, its financial effect, and the nature of the property make it reasonably foreseeable that the decision will have a material financial effect on property (e.g., development potential, use of property, neighborhood characteristics)

Step 5 18705.2 Leasehold Interests

Direct: Presumed material unless the official can prove that the decision will have no effect on the leasehold (e.g., termination of lease, the amount of rent paid, the lessee's right to sublease the property, the allowable use of the property, or the use or enjoyment of the property)

Indirect: Presumed not to be material unless decision will change the legally allowable use or actual use of the property, increase or decrease rent by 5% or more in a 12 month period following the decision, impact the use or enjoyment of the lease, or result in a change in termination date of lease

Step 5: Materiality Standard (cont.)



Step 5: Materiality Standards.

- **Sources of income**

Once you've determined the source, (e.g. individual, business entity, etc.), apply the appropriate standard in the regulation as follows:

Materiality -- Business Entities/Sources of income:

Direct: “One-penny” rule (unless official’s investment is \$25,000 or less and the entity is Fortune 500 or New York Stock Exchange listed -- then apply the applicable indirect standard).

Indirect: Determine the financial size of the entity and apply the appropriate monetary threshold. Effects that are less than the dollar threshold are not considered material.

Indirect Materiality Standards Applied To Different Types Of Businesses

| Business Size | Gross Revenues | Existing Expenses | Assets Liabilities |
|----------------------|-----------------------|--------------------------|---------------------------|
| Fortune 500 | \$10,000,000 | \$2,500,000 | \$10,000,000 |
| New York Stock Ex. | \$ 500,000 | \$ 200,000 | \$ 500,000 |
| NASDAQ/ AMEX | \$ 300,000 | \$ 100,000 | \$ 300,000 |
| Mom and Pop | \$ 20,000 | \$ 5,000 | \$ 20,000 |

Alternate Standard

Indirect Materiality Standards Applied To Different Types of Businesses

| Business Size | Gross Revenues | Existing Expenses | Assets Liabilities |
|---|---------------------------|------------------------------|-------------------------------|
| Earnings before taxes no less than \$2.5 million* | \$ 500,000 | \$ 200,000 | \$ 500,000 |
| Earnings before taxes no less than \$750,000 or net income no less than \$500,000* | \$ 300,000 | \$ 100,000 | \$ 300,000 |

*These figures are self-adjusting to reflect changes in the listing criteria of the NYSE, AMEX and NASDAQ.

18705.3 Persons who are sources of income

Direct: The decision is deemed to have a material financial effect on that source.

Indirect: Once you've determined the source, (e.g. individual, business entity, etc.), apply the appropriate standard in the regulation.

| Sources of income who are Individuals | Income, Assets; Liabilities | Real Property Interests |
|---|--------------------------------|--|
| | \$1,000 or more | 18705.2(b), presumed no MFE absent special circumstances. |

Indirect Materiality Standards Applied to Nonprofit or Governmental Entities

| Nonprofit/gov't entities, if annual gross receipts are: | Gross Receipts | Existing Expenses | Assets or Liabilities |
|--|-------------------|----------------------|--------------------------|
| \$400,000,000+ | \$1,000,000 | \$250,000 | \$1,000,000 |
| \$400,000,000 - \$100,000,000 | \$ 400,000 | \$100,000 | \$ 400,000 |
| \$100,000,000 - \$ 10,000,000 | \$ 200,000 | \$ 50,000 | \$ 200,000 |
| \$ 10,000,000 - \$ 1,000,000 | \$ 100,000 | \$ 25,000 | \$ 100,000 |
| \$ 1,000,000 - \$ 100,000 | \$ 50,000 | \$ 12,500 | \$ 50,000 |
| \$ 100,000 - | \$ 10,000 | \$ 2,500 | \$ 10,000 |

18705.5 Material Financial Effect on Personal Finances

If the decision will affect a public official's personal finances by \$250 in a 12-month period, it is deemed material.

Decisions that affect salary, per diem or reimbursements that the official or official's immediate family receive from local, state or federal government would not be deemed material unless decision was to hire, fire, promote, etc. (Reg. 18705.5.)

Example: Material Financial Effect on Personal Finances

Santa Fe Christian School is a private school located in the City of Solana Beach. The mayor of that city has three children attending the school. Other than paying the school tuition for his children, the mayor has no other relationship with the school. A decision on the Master Plan for expansion of the school is before the city council. May the mayor participate in the decision?

(Brewer Advice Letter, No. A-01-126.)

Step 6. Is it Reasonably Foreseeable that the Economic Interest Will be Affected?

Whether the financial consequences of a decision are reasonably foreseeable at the time a governmental decision is made depends on the facts of each particular case. An effect is considered reasonably foreseeable if there is a substantial likelihood that it will occur.

Certainty is not required. However, if an effect is only a mere possibility, it is not reasonably foreseeable. (*In re Thorner* (1975) 1 FPPC Ops. 198.)

Step 6. Foreseeability (cont.)

Factors: 18706(b)

Nonexclusive list of factors that may be considered in determining reasonable foreseeability:

- (1) The extent to which the official or the official's source of income has engaged, is engaged, or plans on engaging in business activity in the jurisdiction;
- (2) The market share held by the official or the official's source of income in the jurisdiction;

Step 6. Foreseeability (cont.)

(3) The extent to which the official or the official's source of income has competition for business in the jurisdiction;

(4) The scope of the governmental decision in question; and

(5) The extent to which the occurrence of the material financial effect is contingent upon intervening events, not including future governmental decisions by the official's agency, or any other agency appointed by or subject to the budgetary control of the official's agency. (Factors based on *Olson* Advice Letter, No. A-00-237.)

Step 7: The “Public Generally” Exception.

Even if an official's economic interest will be materially affected by a decision, the official can still participate in the decision if the decision will affect the official's interest in substantially the same manner as it will affect a significant segment of the public.

| Economic Interest | What Constitutes a "Significant Segment" |
|--------------------------|---|
| Individuals | 10% or more of population in jurisdiction; or 5,000 individuals who are residents |
| Real Property | 10% or more of property owners/homeowners; or 5,000 property owners or homeowners |
| Business Entities | 2,000 businesses, or 25% of all business entities (<u>Note</u> : Not-for-profit entities are included in this mix and effect must be on more than one single industry.) |
| | An industry, trade, or profession constitutes a significant segment of the public generally if that industry, trade, or profession is a predominant industry, trade, or profession in the official's jurisdiction (i.e. 50%). (Reg. 18707.7). |
| Gov't Entities | All members of the public under the jurisdiction of the gov't agency (<u>Note</u> : Is intended to cover decisions affecting the public in general.) |

Step 7: Public Generally (cont.)

There are a variety of different rules based on the specific facts of the decision. For example:

- Members of appointed boards and commissions
- Rates, assessments and similar decisions.
- States of emergency
- Single industry, trades and professions
- Sources of income to owners of retail businesses

Step 7: “Public Generally” (Cont.)

For example:

Rates, assessments and similar decisions: If 10% or more of the property owners will be affected, either by the same percentage or across-the-board, the “public generally” exception applies.

**In addition, the significant segment
must be affected in
*"Substantially the Same Manner"***

- Important part of the analysis for "public generally" rule
- Factually based determination

Step 8: Legally Required Participation

The Act does not prevent government from acting when it is legally required to do so. If so many officials are disqualified that the agency cannot act, the agency may bring back sufficient disqualified officials under the following conditions:

- (a) Disqualified official(s) **must disclose with “particularity” the economic interest** that is the basis for the conflict of interest;
- (b) The decision must be one where no alternative method exists for it to be made;
- (c) Only the **minimum number** of members **required to make a quorum** are brought back;
- (d) A random selection method is preferred.

Step 8: Legally Required Participation (cont.)

The "particularity" of the disclosure under the regulation is satisfied so long as the official discloses both of the following:

(1) Whether the conflict involves an investment, business position, interest in real property, or the receipt of income, loans or gifts; and

(2) If the economic interest is an investment

The name of the business in which each investment is held

If it is a business position

A general description of the business activity in which the business is engaged

If it is an interest in real property

The address or another indication of the location of the property, unless the property is the official's principal or personal residence, in which case the official shall disclose this fact

Step 8: Legally Required Participation (cont.)

The legally required participation rule may not be invoked:

- (a) To break a tie;
- (b) When a quorum can be convened of members of the agency who are not disqualified due to a Political Reform Act conflict; or
- (c) When a qualified member of the agency is absent.

Additional Resources

For a copy of the Political Reform Act, regulations, fact sheets, Commission meeting materials, or general information:

Visit the Commission's website
www.fppc.ca.gov

Call Toll-free (866) ASK-FPPC
or (916) 322-5660.

The Commission's advice letters are available on the legal research services Westlaw and Lexis-Nexis.